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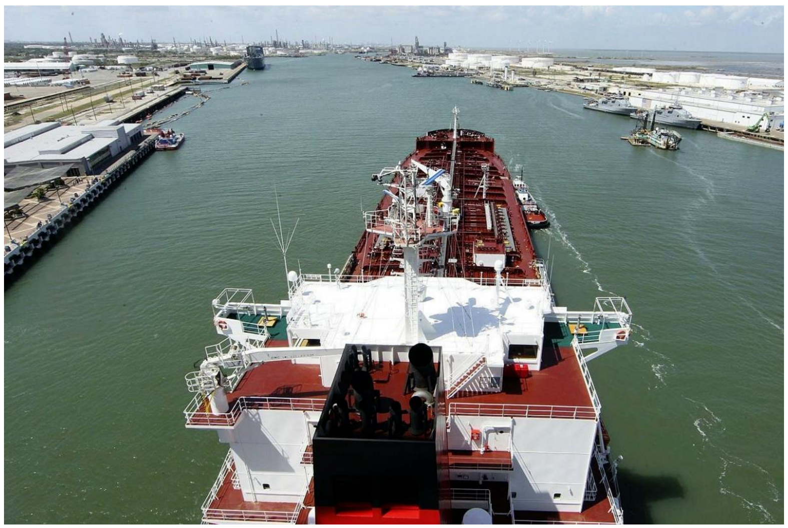
ECONOMY | THE OUTLOOK

Cheaper Oil Isn't the U.S. Boon It Used to Be

Expanded domestic production has tied more of the nation's investment, manufacturing and jobs to oil



The M/V Pennsylvania tanker pulled into the Port of Corpus Christi, Texas, to load oil from the Eagle Ford Shale fields earlier this year. The U.S. has risen to become the world's largest oil producer.
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By Paul Kiernan and Christopher M. Matthews

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The U.S. economy's relationship with oil is changing.

In the past, when the U.S. imported most of its energy needs, declining oil prices were a bounty to households and businesses. A rule of thumb was simple: Oil-price drops boosted U.S. economic output.

That's become more complicated. As the U.S. has risen to become the world's largest oil producer this year, a growing chunk of domestic investment, manufacturing output and employment has become tied to oil. Now, when oil prices fall, it risks hurting investment and hiring in important parts of the economy.

At the same time, a decades-long transition toward more energy-efficient living has left businesses and consumers less sensitive to prices at the pump, meaning they don't benefit as much when prices fall.

Some economists still believe lower oil prices are a net economic positive, but the resurgence of the U.S. oil industry has upended the conventional wisdom held by many, including President Trump, who has recently issued a flurry of tweets calling for even cheaper crude.

"Oil prices getting lower. Great! Like a big Tax Cut for America and the World. Enjoy! $54, was just $82. Thank you to Saudi Arabia, but let's go lower!" Mr. Trump tweeted on Nov. 21.

Oil companies, setting capital-expenditure plans for the next year, could be spooked into cutting budgets if prices keep sliding. Crude oil futures have lost a third of their value in less than two months.

"He's living in the old world," Ian Shepherdson, chief economist at Pantheon Macroeconomics, said of Mr. Trump's comments in recent weeks cheering the price declines. "That's the very last thing he should be wishing for."

In the past, the U.S. oil industry focused on the Gulf of Mexico, where massive deep-water wells required large up-front investments that pumped vast quantities of oil for a decade or more at relatively low operating costs. Output was dominated by big companies such as Exxon Mobil Corp. and Royal Dutch Shell PLC, which carried little debt.

As a result, energy investment was relatively unresponsive to short-term price fluctuations, while a drop in gasoline prices immediately left consumers with more cash to save or spend on other goods and services.

Then the equation changed.

Fuel-efficient vehicles and a long transition away from heavy industry mean the U.S. economy now consumes just 0.4 barrels of oil to produce $1,000 of gross domestic product, down from 1.1 barrels in 1972, said Martin Stuermer, a senior research economist at the Dallas Fed.

In contrast to the Gulf of Mexico's heyday, most U.S. oil nowadays is extracted from a vast number of comparatively tiny deposits trapped in shale rock.

Since wells are exhausted quickly, the process requires near-constant drilling by a constellation of smaller companies that, compared to the traditional oil majors, use a lot of debt. This makes both production and investment sensitive to lower prices, which can lead to sudden bankruptcies or declines in cash flow that squeeze investment plans.

Large shale-oil companies, such as EOG Resources Inc . and Whiting Petroleum Corp . , have characterized the current price around $50 a barrel as an inflection point, below which they would reduce drilling.

"If oil went down to $40 and stayed there, yes, you would see a reduction in [spending] and a reduction in U.S. production growth," said Chris Wright, the chief executive of Liberty Oilfield Services Inc., a hydraulic fracturing company that works for oil producers.

Economic data from the last big downturn in oil prices reflect the new dynamic. Months after oil prices began falling from their mid-2014 peak of $105 a barrel, drilling slowed. By late 2016, private investment in oil and natural gas exploration and wells had fallen by two-thirds, and the oil-and-gas industry had shed nearly 190,000 jobs.

The negative effects of the price downturn were most acute in oil-producing regions like Texas and North Dakota, but national measures of business investment slowed, too, and overall expansion of GDP sputtered.

It's still difficult to map the complete footprint of oil in the U.S. economy. The Bureau of Economic Analysis estimates business investment in petroleum and natural gas structures at $137.48 billion annually. While that's less than half of what consumers spend on gasoline and motor fuel—$324.51 billion—it includes none of the homes, hospitals and strip malls that pop up in regions that pump oil.

"A decline in oil prices now has negative spillovers to U.S. aggregate investment," said Nida Cakir Melek, an economist at the Federal Reserve Bank of Kansas City.

Joseph Jaquez, who runs his family's store, Airlawn Furniture in Pecos, Texas, said the oil boom created a windfall for his business in the heart of the Permian basin when thousands of workers flocked to the area. His sales of mattresses boomed to the temporary housing facilities that popped up in town.

"Our situation here in town is not one that many people can comprehend," Mr. Jaquez said.

Mr. Shepherdson, the economist, said it's not a coincidence that the 2014-16 period of falling oil prices was followed by a marked slowdown in broader economic growth.

The recent price downturn, he estimates, will subtract 0.3 percentage points from U.S. GDP growth over the next year or so.

Write to Paul Kiernan at paul.kiernan@wsj.com